ICRA Lanka reaffirms the ratings of Commercial Credit and Finance PLC

July 09, 2019

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	[SL]BBB with Negative outlook reaffirmed
Commercial Paper Programme	1,000	[SL]A3; Assigned
Listed Guaranteed Subordinated Redeemable Debentures Programme	1,000	[SL]AA- (SO) with Stable outlook reaffirmed
Listed Guaranteed Subordinated Redeemable Debentures Programme	2,000	[SL]A+ (SO) with Stable outlook reaffirmed

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of Commercial Credit and Finance PLC (CCFL or the Company) at [SL]BBB (Pronounced SL triple B) with Negative outlook. ICRA Lanka has assigned the short-term rating of [SL]A3 (Pronounced SL A three) to the Company's commercial paper programme of LKR 1,000 Million.

ICRA Lanka has reaffirmed the issue rating of [SL]AA-(SO)[1] (pronounced SL Double A Minus Structured Obligation) with Stable outlook for the LKR 1,000 Million guaranteed subordinated redeemable debenture programme of the Company, which is currently listed on the Colombo Stock Exchange. This rating is based on the strength of the unconditional and irrevocable guarantee from Hatton National Bank PLC (HNB) for the principal amount of LKR 1,000 Mn and the two quarterly interest instalments of LKR 52.5 Mn maintained as a security deposit with the Trustee. The guarantor undertakes the obligation to pay, on demand from the Trustee, LKR 1,000 Mn, the principal amount of the subordinated redeemable debentures. ICRA Lanka also factors in the undertaking from the Trustee to utilize the security deposit to pay the interest amount due to the investors and declare the entire guaranteed amount as payable, in the event the issuer does not meet the scheduled interest payment on any due date or in the event the issuer does not redeem the debenture in full on any redemption date and redeem the instrument in full. The rating also assumes that the guarantee will be duly invoked by the Trustee, as per the terms of the underlying Trust deed, Trustee's undertaking and guarantee agreements, in case there is a default in payment by CCFL.

ICRA Lanka has also reaffirmed the issue rating of [SL]A+(SO)[1] (pronounced SL A plus Structured Obligation) rating with stable outlook for the LKR 2,000 Mn guaranteed subordinated redeemable debentures programme, which is currently listed on the Colombo Stock Exchange. This rating is based on the strength of the unconditional and irrevocable guarantees from Sampath Bank PLC (Sampath) and HNB covering the principal and two interest instalments (semi-annual) of the debenture programme. Each guarantor undertakes the obligation to pay, on demand from the Trustee, LKR 1,000 Mn, being 50% of the total principal sum of LKR 2,000 Mn and, one half-yearly interest instalment of the Subordinated Redeemable Debentures. The rating also assume that the guarantees will be duly invoked by the Trustee,

[1] The letters SO in parenthesis suffixed to a rating symbol stand for Structured Obligation. A SO rating is specific to the rated issue, its terms, and its structure. The SO ratings do not represent ICRA Lanka's opinion on the general credit quality of the issuer(s) concerned

as per the terms of the underlying Trust deed and guarantee agreements, in case there is a default in payment by CCFL.

Rationale

The reaffirmation of the issuer rating with a negative outlook factors in the continued weakness in CCFL's asset quality profile and stretched liquidity profile. CCFL's gross NPA ratio increased to 7.1% as of May-19 vis a vis 6.5% as of Mar-19 (7.0% as of Mar-18) largely because of challenging macro environment. The ALM mismatch (in <1-year bucket) increased to -13.4% as of Mar-19 vis a vis -0.3% as of Mar-18, largely because of the shift in the portfolio towards longer term leasing products. The rating continues to factor in CCFL's established business presence in Sri Lanka and the experienced senior management team, its adequate profitability indicators and capital structure. ICRA Lanka takes note that, given the Company's moderate growth expectation (CAGR 12% over the next 3 years), the internal generation would be sufficient to grow its portfolio, without adversely impacting its capital profile. However, CCFL may need to infuse capital to its subsidiary, Trade Finance and Investment PLC, for it to meet the upcoming minimum capital requirement and support its aggressive portfolio growth target (CAGR 50%) over the next 3-years.

ICRA Lanka further takes cognizance of the Company's exposure to customer segments with modest credit profile that is highly vulnerable to economic cycles. The rating also factors in the increased competition and stricter LTV rules, which may hinder CCFL's ability to attract quality credit. Going forward, the Company is expected to grow with focus on leasing, gold loans and other asset backed lending; Microfinance (MF) and other unsecured loan share in the overall portfolio is expected to reduce from the current levels (15%) to about 10% over the next 3-years. Ability to maintain good asset quality in these segments would be critical going forward.

Outlook: Negative

The negative outlook reflects the continued weakness in CCFL's asset quality indicators and stretched liquidity position. The outlook may be revised to 'Stable' in case of steady improvement in CCFL's asset quality and liquidity position while maintaining a comfortable capital and earnings profile. The rating may be downgraded in case of a further moderation in asset quality or liquidity profile or if the capital and earnings profile of the Company weakens.

Key rating drivers

Credit strengths

Established franchise and experienced senior management team: CCFL has an island wide presence through its 118-branch network. CCFL is one of the large non-banking financial institution in Sri Lanka with an asset base of LKR 80 Bn as of Mar-19. The Company was not able to proceed with the new branch openings as envisaged during FY2019 because of non-receipt of regulatory approvals. It closed down 3 microfinance lending branches. The promoter/CEO and the senior management team are experienced professionals in financing business.

Adequate profitability; though declining over the period: CCFL's RoA (PAT as a percentage of average total assets) stood adequate at 2.5% as of Mar-19 (2.8% as of Mar-18 and 3.8% as of Mar-17) though the same has been moderating. The profitability was largely affected by increased operating expenses during FY2019. Operating expenses (as a percentage of average assets) increased to 9.0% in FY2019 from 7.7% in FY2018, largely on account of moderation in overall growth. CCFL was able to maintain its lending yields around 28-29% by increasing its exposure to registered and unregistered 2-Wheelers and 3-Wheelers, while it reduced its exposure on microfinance. The Company's NIM stood at 14.6% in FY2019 (14.2% in FY2018 and 15.6% in FY2017). CCFL's credit cost moderated to 2.8% in FY2019 vis a vis 3.4% in FY2018 partly because of the direct balance sheet adjustment of first day impact of transitioning into IFRS 9, which was about LKR 2.9 Bn. Going forward, maintaining healthy level of profitability would be crucial for CCFL to fund the portfolio growth given the higher capital adequacy requirements coming into effect in each July until 2021.

Adequate capital structure: CCFL's gearing stood moderate at about 5.4-5.5 times as of Mar-19 and Mar-18 vis a vis 7.0 times as of Mar-17 (8.1 times in Mar-16) because of the degrowth in the portfolio during the two-year period. Going forward, the envisaged CAGR in portfolio is 12% per annum over the next 3-years and gearing is likely to remain at current levels. The core and total capital adequacy ratios (CAR), post incorporating unaudited PAT for FY2019 (about LKR 2.1 Bn) was adequate at 11.5% and 13.0% respectively as of Mar-19. This is after the net impact of LKR 2.1 Bn first day adjustment of transitioning into IFRS 9 standard. ICRA Lanka expects CCFL's internal generation to be adequate to maintain its envisaged growth of about 12%. However, CCFL may need to infuse capital to its subsidiary, Trade Finance and Investment PLC, for it to meet the upcoming minimum capital requirement and support its aggressive portfolio growth target (CAGR 50%) over the next 3-years.

Credit challenges

Weak asset quality indicators: CCFL's gross NPA ratio improved to 6.5% as of Mar-19 vis a vis 7.0% as of Mar-18 (4.4% as of Mar-17), however the same increased to 7.1% as of May-19. The improvement in FY2019 was because of the management's focused effort on collection and recoveries and write off of about LKR 4.7 Bn (7.1% of gross portfolio as of Mar-19) from the fully provided facilities, during FY2019. The gross NPA ratio of non-asset backed lending segment, namely factoring, term loans (including unsecured working capital lending) and microfinance increased to 34.6%, 13.9%, 17.6% respectively as of Mar-19 from 22.8%, 13.7% and 7.0% respectively as of Mar-18 accentuated to an extent by the portfolio decline. The leasing portfolio's gross NPA ratio improved to 4.7% from 8.1% during the same period because of write off and the growth in the portfolio, witnessed largely in 3Ws and 2Ws. ICRA Lanka takes note of the steady shift towards asset backed lending by CCFL over the recent past; 85% of the portfolio is backed by assets as of Mar-19 (68% as of Mar-18 and 62% as of Mar-17). ICRA Lanka notes that overall delinquencies in 90+ days past due (dpd) stood high at about 16% as of May-19 (13% as of Mar-18 and 9% as of Mar-17) largely on account of the temporary disruption of business operations after terror attack in April 2019. Therefore, the Company's ability to control slippages from the softer buckets while bringing down the NPAs, would be a key monitorable going forward.

Operating environment characterized by high competition and susceptibility to unfavorable regulatory changes: CCFL's portfolio stood at about LKR 66 Bn as of Mar-19 (LKR 70 Bn as of Mar-18) with about 59% exposure to leasing and HP, 21% to loans, 11% to microfinance and 8% to gold loans. ICRA Lanka notes the reduction in Company's microfinance exposure to 11% as of Mar-19 from 18% as of Mar-18. The Company expects to grow its leasing & HP portfolio to about 70% of its portfolio by FY2022, with a focus on 2Ws and 3Ws asset classes accounting for more than 50% of the portfolio. This customer base mainly comprises of individuals with modest credit profiles, who are susceptible to volatile economic environments. In addition, the operating environment is quite competitive with established NBFIs and banks competing for market share. Further, the leasing business is susceptible to adverse regulatory changes as observed in the recent past. On the back of these challenges, it would be crucial for CCFL to attract quality credit to achieve its envisaged growth.

Stretched liquidity profile: The Company is largely dependent on deposits, which accounted for 81% of the total funding base as of Mar-19 (83% as of Mar-18) while debt instruments and bank borrowings accounted for the balance. The Company's cumulative ALM mismatch (in <1-year bucket as a proportion of total assets) widened to -13.4% as of Mar-19 from -0.3% as of Mar-18, largely because of the shift in the portfolio to long term leasing as opposed to short term loan products in the past. CCFL's deposit renewal rate at 70% also provided comfort in terms of liquidity over the last few years. Going forward, it would be critical for the Company to diversify its funding profile and secure longer tenure funding to offset liquidity related risks as it further increases focus on longer tenure secured loans.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.
Links to applicable criteria: ICRA Lanka's Credit Rating Methodology for Non-Banking Financial Institutions

About the Company:

CCFL, a registered finance company, offers leasing, hire purchase, business credit facilities, microfinance, factoring, term loans and other personal loans apart from accepting deposits (fixed and savings). The Company was established in 1982 as a specialized leasing company in Kandy. In October 2009, BG Investments (Pvt) Ltd. acquired the controlling stake of the Company. Since the change of ownership, the Company has rapidly expanded its service locations to about 118 from about 22 in FY2012. The Company has an employee base of about 3,400. CCFL's shares were listed on the Dirisavi Board (secondary board) of the CSE in June 2011. The Company witnessed investments from the impact investor, Creation Investment Sri Lanka LLC in March 2014 and regional NBFI, Group Lease Holdings Pte Ltd in December 2016. As of March 2019, BG Investment (Pvt) Ltd held 50.25% of the shares, while Group Lease Holdings Pte Ltd. held 29.99%, Creation Investments owned about 8.67%. During FY2015, the Company acquired majority stake in Trade Finance and Investments PLC, which presently is a 99.7% owned subsidiary.

During the year ended March 31, 2019, CCFL reported a net profit of LKR 2,074 Mn (unaudited) on a total asset base of LKR 80,381 Mn as compared to net profit of LKR 2,351 Mn on a total asset base of LKR 83,793 Mn in the previous fiscal year. The consolidated net profit for the year ended March 31, 2019 stood at LKR 2,622 Mn (unaudited) on a total asset base of LKR 89,551 Mn. The same was LKR 2,542 Mn on a total asset base of LKR 90,119 Mn in the previous fiscal year.

Guarantor Profiles:

Hatton National Bank PLC
Hatton National Bank PLC (HNB) is one of the larger private sector commercial banks in the country with total assets amounting to LKR 1,084 Bn as at March 31, 2019. It accounted for 9.2% of sector assets, 9.9% of sector loans and advances and 9.3% of sector deposits as of March 31, 2019. The Bank was incorporated in the present form in the year 1970. Stassen's group with 17.8%, Sri Lanka Insurance Corporation Ltd with 12.5% and Employee Provident Fund with a 9.8% stake are the major shareholders of the Bank.

The Bank recorded a total income of LKR 31,372 Mn for the 3MCY2019 and LKR 121,356 Mn for CY2018 (LKR 106,295 Mn for CY2017). The net profits of the Bank amounted to LKR 2,031 Mn during 3MCY2018 and LKR 15,518 Mn for the CY2018 (LKR 16,467 Mn for CY2017), which resulted in ROAA (PAT as a proportion of average assets) of 0.75% and 1.52% (1.82% in CY2017) for the respective periods. The Bank had a gross NPA ratios of 4.63% and 2.78% as at 3MCY2019 and CY2018 (2.28% in CY2017) and net NPA ratios of 2.92% and 1.11% respectively for the said periods (0.77% in CY2017). The Bank had a net worth of LKR 115,459 Mn as on March 31, 2019 with tier 1 capital adequacy ratio of 12.56% and total capital adequacy ratio of 14.79%.

Sampath Bank PLC
Sampath Bank PLC is one of the larger private sector commercial banks in the country with total assets of LKR 911 Bn as at March 31, 2019. Sampath accounted for 7.8% of the banking industry assets, 8.6% of the sector loans and advances and 8.1% of sector deposits as of March 31, 2019. The Bank commenced operations as a licensed commercial bank in 1987 and was noted for introducing technology to the banking sector. Major institutional shareholders include Vallibal One PLC with a 14.95% and Employee Provident Fund with a 9.97% stake. The Sampath group companies include Sampath Centre Ltd (97.14%), SC Securities (Pvt) Ltd (100%), Siyapatha Finance PLC (100%) and Sampath Information Technology Ltd (100%).

The Bank recorded a total income of LKR 28,865 Mn for the 3MCY2019 and LKR 115,310 Mn for CY2018 (LKR 92,590 Mn for CY2017). The net profits of the Bank amounted to LKR 2,163 Mn during 3MCY2019 and LKR 12,143 Mn for CY2018 (LKR 12,104 Mn for CY2017), which resulted in ROAA (PAT as a proportion of average assets) of 0.95% and 1.42% (1.67% in CY2017) for the respective periods. The Bank had gross NPA ratios of 4.87% and 3.69% as of Mar-19 and Dec-18 (1.64% as of Dec-17) and net NPA ratios of 3.42% and 2.39% respectively for the said periods (0.75% as of Dec-17). The Bank had a net worth of LKR 84,634 Mn as on March 31, 2019 with tier 1 capital adequacy ratio of 11.72% and total capital adequacy ratio of 16.19%.

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